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SUBJECT: AES EXPANSION PLANS INDICATE POWER SECTOR SUCCESS STORY IN
INDIA'S SMALLER MARKETS

REF: A) 07 NEW DELHI 2078; B) 07 NEW DELHI 5003

11. (SBU) SUMMARY: AES India, the wholly-owned Indian subsidiary of the US energy major AES Corporation, will invest around USD 1.2 billion each in two 1,200MW capacity coal-based power plants in Orissa and Chhattisgarh over the next few years. Collectively, the USD 2.4 billion investment will be the largest by any multinational company in the Indian power sector. The company is today the largest US investor in the Indian power sector, and is now formulating a long term strategy in India, evaluating bidding and acquisition opportunities and focusing on developing a portfolio of renewable projects in the country. The road to success was not without significant hurdles, but AES' experience demonstrates that perseverance in key sectors can pay off. END SUMMARY

Two 1200 MW Projects - Orissa and Chhattisgarh

12. (U) AES Corporation picked up a 49 per cent stake in Orissa Power Generation Corporation (OPGC) in 1994, making it the first foreign company operating in India's power sector. Currently, OPGC runs two 210 MW plants in Ib Valley in Orissa's Jharsuguda district. AES plans to augment its generation capacity by 1200 MW by adding two 600 MW thermal power plants at an investment of USD 1.2 billion. According to AES sources, considerable pre-project work has been accomplished. Land for the power plant plus adequate water supply as well as clearance from the Civil Aviation Ministry (for chimney height) are in place. Coal will be sourced from the Manoharpur blocks in Ib Valley that have been allocated to OPGC. The coal reserve there is estimated at 531 million tons.

13. (U) OPGC will finalize its engineering consultations for the project by the end of April 2008, and the tendering process for appointing engineering, procurement and construction (EPC) contractors should start in August (the project is targeted for completion within 42-48 months from the issuance of 'notice to proceed' to the EPC contractor). Environment clearances are expected by October 2008, and the company hopes to reach financial closure on the deal by the second quarter of 2009.

14. (U) In addition to its Orissa plans, AES Corporation, through its subsidiary AES India Private Limited, signed a Memorandum of Understanding with the Government of Chhattisgarh in March 2006 to set up a 1200 MW thermal power project with integrated captive coal mine in that state. The expected investment in this project is reported to be USD 1.2 billion. AES received the necessary clearance from the GOI in November

2006 for bringing in foreign investment for this project. AES India has formed a special purpose vehicle called AES Chhattisgarh Energy Private Limited (ACE) to set up and implement the project.

15. (U) AES applied to the federal Ministry of Coal (MoC) for the allocation of a captive coal block in January 2007. In November 2007 the MoC allocated the Sayang Coal Block in Mand-Raigarh Coalfields in Chhattisgarh for the project. The coal block is 20 kilometers from the power plant site. AES still needs to obtain clearances from various government departments including the federal environmental and forestry department before commencing exploration activities, and mine development is expected to take three to five years. The company has made significant progress in terms of project site identification, application for land acquisition, power evacuation studies and water allocation. AES estimates that it will take a year to obtain the required permits and expects to achieve financial closure by March 2009. The new plant is expected to commence power generation by September 2012.

CSR activities in Orissa and Chhattisgarh

16. (U) Orissa and Chhattisgarh are two of India's poorest states both with considerable tribal populations. These are also states in which Maoist insurgencies, fueled by a lack of economic development and poverty, continue to pose serious threats to India's internal security. Corporate Social Responsibility (CSR) activities can be useful in garnering local support for projects. In Orissa, OPGC has started a drinking water project to supply water to villages around its power plant. The first phase of the project is complete and water is now being supplied to six villages. The second phase starts this year. OPGC is organizing medical camps in villages around the

KOLKATA 00000123 002.2 OF 003

OPGC plant and near allocated mines to provide free medical services to villagers. OPGC also runs a 20-bed hospital, which supports the needs of villages near its plant. OPGC is also extending financial support to local schools in the surrounding villages by building classrooms, school boundary walls, and community halls. In Chhattisgarh, AES is in the initial stages of community engagement and plans to carry out CSR activities in the areas of education, medical, sanitation, and water supply.

17. (SBU) AES wrote a letter of appreciation to U.S. Embassy New Delhi, thanking Post's Commercial and Economic Sections, Consulate Kolkata, and Consulate Mumbai for their strong and persistent advocacy over two years with the state governments, the Ministry of Coal and the Ministry of Power on behalf of AES' Orissa and Chhattisgarh power projects, including a crucial coal block allocation approval in November 2007 (ref a). USG efforts included letters from Ambassador Mulford and representations to the ministries during USDOC Assistant Secretary Bohigian's meetings on April 19, 2007 (ref b). ConGen Kolkata has also advocated for AES interests with the Orissa Government. Embassy New Delhi had underscored to the GOI that many U.S. power companies and investors were watching the AES project as a test case of whether they should consider re-entering India's power sector, including for the proposed Ultra-Mega Power Projects.

Renewable energy in the Sunderbans

18. (U) AES' renewable energy project in the ecologically fragile Sunderbans region of West Bengal is a 2 megawatt off-grid distributed generation project using primarily biomass as a fuel. This project is expected to supply electricity to about 20,000 village households on the island of Gosaba, one of about a fifty inhabited islands in the Sunderbans. The West Bengal Renewable Energy Development Agency (WBREDA), a State Government promotional agency for renewable energy, originally

conceived of the project. The islands do not come under the jurisdiction of the West Bengal State Electricity Board, therefore WBREDA has in principle agreed to purchase power from the project and sell it to the local population.

¶9. (U) AES India and Amrit Bio-Energy & Industries Limited, a private company, have established a joint-venture company (AES Amrit Power Projects Pvt. Ltd.) to develop the Sundarbans project and hold all project rights, permits and contracts. AES India and Amrit will jointly fund the development expenses in proportion to their equity holdings in the new company. Amrit will implement the project and control day to day management. Additionally renewable energy ventures AES is considering include development of hydro and wind projects. AES is also evaluating its potential participation in carbon offset activities designated as "Clean Development Mechanism" projects under the Kyoto framework.

Status of pending court cases

¶10. (U) AES has two disputes concerning its power sector investments in the state of Orissa, which it is contesting through multiple court cases. (Note: In a meeting with ConGen in late 2007, Orissa Chief Minister Naveen Patnaik declared that the legal issues surrounding generation and distribution of power were "resolved" and that the state was moving forward. End note.) In 1998, AES purchased a 49 percent equity share in the Orissa Power Generation Corporation (OPGC), which owns and runs two 210 MW thermal units, from the Government of Orissa (GOO) in an international competitive bid at a price of USD 143 million. In its second investment in 1999 AES paid approximately USD 10 million for a 51 percent stake in the Central Electricity Supply Company (CESCO).

¶11. (U) In an international arbitration proceeding GRIDCO (a GOO owned transmission company) had claimed recovery of losses from AES towards its 51 percent stake in the distribution business of CESCO in the state. Hearings concluded in August ¶2005. In June 2007 arbitrators dismissed both GRIDCO's claims and AES's counter claims, and closed the arbitration process. GRIDCO has challenged the arbitration order in a local court.

¶12. (U) In a separate petition initiated by GRIDCO before the Supreme Court, in conjunction with its claims in the CESCO case,

KOLKATA 00000123 003 OF 003

GRIDCO sought to enjoin AES from drawing dividends from OPGC and from the sale of its shares in OPGC. While the Supreme Court allowed AES to continue drawing dividends, it reserved judgment on the sale of OPGC shares pending the outcome of the arbitration proceedings. With the arbitration order going in AES' favor, the Supreme Court ruled for AES.

¶13. (U) OPGC had also sought relief in the Supreme Court against a case filed by GRIDCO with the State Regulator that would have reopened the Power Purchase Agreement (PPA). The Court stayed further proceedings of the State Regulator, pending further hearing. In the interim, OPGC has initiated a settlement process with the Orissa government and GRIDCO. The Government of Orissa (GOO) constituted a Task Force to look into the OPGC-GRIDCO dispute relating to the existing Power Purchase Agreement (PPA). The Task Force has concluded its meetings and has placed its recommendations before the government, pending final approval. AES expects that with the GOO taking an active interest in resolving pending disputes, OPGC will go ahead with its 1200 MW capacity expansion proposal. (Note: The GOO has already demonstrated its support for AES by recommending allocation of captive coal mines for OPGC for the expansion project. In response, the federal Ministry of Coal, has allocated two coal blocks to OPGC in Jharsuguda district in Orissa. End Note.)

¶14. (U) In another case initiated by AES before the Company Law Board (CLB), citing oppression of minority share holder (AES) by

the majority share holder (GOO), the CLB issued an order in favor of AES. The order has been challenged by the GOO in the local courts, and is pending a hearing.

AES' future plans in India

¶15. (U) AES is among the eleven bidders that has cleared the first stage of competitive bidding for the 4000 MW Tilaiya Ultra Mega Power Project (UMPP). The company is evaluating the details and will be working out a strategy to participate in the next phase of the bidding process. AES considers India as one of their key markets for growth in its core business of power generation as well as for renewable energy. While AES continues to focus on the development of the 1200 MW OPGC expansion project and 1200 MW Chhattisgarh greenfield project, they continue to evaluate bidding and acquisition opportunities elsewhere in the country and are focusing on developing a portfolio of renewable projects.

¶16. (U) COMMENT: In spite of initial hurdles, AES is continuing to build on its presence in India. The fact remains that India is still eager to meet its seemingly insatiable appetite for energy. There are lessons to be learned from AES' experience - unlike some foreign energy companies that made much publicized entries into India (example Enron, Unocal, Cogentrix among others) only to make an exit within a few of years, AES' made a long term commitment to stay, which has borne profits and a growing presence in the important Indian market. AES has also been willing to operate in eastern India. Although it is a region with high poverty, weak development, and is often shunned by investment, the eastern region still contains most of the critical mineral resources needed for India's power and industry. While litigation has been a source of frustration for AES, it is important to note that AES continually has been making a profit from its operations in Orissa, even while the court cases were ongoing. Although the initial years of entry in the power sector might involve managing complex regulatory schemes and other difficulties, AES's experience shows that it does pay to stay for the long haul.

JARDINE